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SUBJECT: VIETNAM APPROVES SECOND STIMULUS PACKAGE

¶1. (SBU) Summary. Vietnam has approved a second stimulus package that extends and modifies elements of the existing package into ¶2010. This decision was hotly debated, with some economists and National Assembly (NA) members arguing that the danger of resurgent inflation outweighed any need for additional growth. Proponents discounted the inflation risk and argued that the announced package is largely psychological, with a value much smaller than the prior stimulus. Additional stimulus, however, risks putting increased pressure on the local currency. This step suggests that internal political pressures to reach GDP growth targets continue to be stronger than concerns for price stability. End summary.

The Rationale for Stimulus

¶2. (U) After much debate, on October 30 the GVN announced that it would extend its stimulus plan into 2010 to ensure the steady recovery of the economy. This decision was premised on several assumptions: (1) the recovery of the world economy will be slow and uncertain; (2) domestic enterprises need a soft landing from the interest subsidies provided under the earlier stimulus; (3) the consumer price index (CPI) increase in 2010 is unlikely to exceed 10%; and (4) continued stimulus will not further significantly burden the budget as only 70 percent of previously budgeted stimulus funds have been disbursed.

The Stimulus Package

¶3. (U) The size and details of this second stimulus are not completely clear, but will likely be much smaller than the first package. The first package included four components: subsidized lending, public investment, tax breaks and social spending. Subsidized lending for short-term working capital, because of its immediate impact, was seen as the core of the first package and will be continued through the first quarter of 2010. However, the GVN will reduce the interest rate subsidy from 4 percent to 2 percent. Interest rate subsidies provided for medium- and long-term credit will also be extended at the reduced subsidy. However, in response to calls for stricter supervision of the second package, this extension will focus on medium- and long-term credit for infrastructure investment, particularly in agriculture, labor-intensive industries, export-oriented enterprises and small and medium enterprises.

¶4. (U) Following the initial announcement, more recent statements have been vague about the scope and duration of the extension of the lending subsidies beyond the first quarter of 2010, stating

only that the State Bank of Vietnam and the Ministry of Industry and Trade will consider and make recommendations later on continuing the subsidies. The second stimulus will not extend further tax reductions and exemptions, including corporate income tax, value added tax and personal income tax. Deferring of corporate income tax, however, will be permitted for an additional three months beyond the end of this year.

Stimulus Dissent from the National Assembly

¶5. (U) Despite expectations to the contrary, the second stimulus package was not sent for NA review prior to its announcement. Following the announcement, on November 2, Dinh Van Nha, Vice Chairman of the Budget and Finance Committee of the NA, told journalists that the second stimulus would not be implemented until it gets NA approval. In a press interview on November 4, Nguyen Duc Kien, Vice Chairman of the National Assembly said that, "we should not launch a second stimulus at this point of time," and that, "the National Assembly has not been informed of the source of funding." In addition, both the Finance and Economic and Budget Committees of the NA recommended stopping subsidized lending as scheduled on December 31. While the GVN has made assurances that it can finance additional stimulus, funding was not included in the new budget recently approved by the National Assembly. Despite the

NA's statements, it is likely that the package will go forward.

¶6. (SBU) A National Assembly member from Ho Chi Minh City (HCMC) who serves on the Finance and Economic Committees told the Consul General that, while the first stimulus package may have played a role in avoiding an even worse slowdown, it did not reach its intended target of small and medium enterprises (SMEs). Based on a review conducted by the NA, he estimated that 80% of all subsidized loans went to large SOEs or joint ventures of SOEs. The majority of the remainder went to large private companies, with only about two percent of the total reaching SMEs. He believes that moves to extend the subsidy have more to do with propping up SOEs than with helping the economy as a whole. He expressed his fear that the true cost of supporting the SOEs will be felt both in inflation in the second half of 2010 and in a continuing decline in investment effectiveness in Vietnam.

IMF Opposition to Further Stimulus

¶7. (SBU) The International Monetary Fund (IMF) had hoped for no second stimulus package and was disappointed by this step, citing the risks for future inflation. The IMF had recently recommended to the GVN: (1) an orderly exit from the stimulus; (2) early monetary tightening; and (3) reassurance of a conservative (non-expansionary) fiscal policy. IMF Resident Representative Benedict Bingham told Econoff that he believed this choice was primarily a response to the political pressures of the upcoming 2011 Party Congress, as well as to continuing uncertainties regarding global growth. Bingham also said that the GVN is betting on being able to prevent any serious balance of payments problems by: (1) increasing exports; (2) increasing FDI inflows; and (3) seeking better portfolio (indirect investment) inflows that will stick.

¶8. (SBU) The IMF thinks that the chief risks for future macroeconomic instability come from rising inflation and pressure on the foreign exchange market. Bingham noted that the World Bank and Asian Development Bank share the IMF's concerns regarding the

GVN's balance of payments. Bingham stated, however, that the greatest pressure on the local currency is not from the GVN's weakening balance of trade or lower remittances, which together account for only a $1.9 billion drop in Vietnam's foreign exchange reserves, but from the "other" private capital outflows of some $3.3 billion during the first half of 2009. Bingham states that this outflow likely resulted from private "portfolio shifts" from Vietnamese dong into dollars and gold, resulting from: (1) uncertainty, (2) perceptions of a risk of devaluation, and (3) the GVN's economic stimulus, particularly the interest rate subsidy, increasing the supply of dong, and undermining confidence in the currency.

Private Sector Wants the Psychological Impact of Another Stimulus

¶9. (SBU) In the Southern Key Economic Zone (SKEZ) including Ho Chi Minh City, Binh Duong, Dong Nai and neighboring provinces, most foreign-invested company managers say the direct benefits of the stimulus package have been directed to the state-owned enterprises and the clients of the state-owned commercial banks. They want a stable macroeconomic environment and worry that stimulating growth will lead to inflation and other problems associated with a rising cost of living, such as the worker wage strikes at manufacturing companies in 2008. In contrast, investment fund managers support a second stimulus package that will create additional growth, arguing that the proposed package is small and much of the possible inflationary pressure would be offset by taxes scheduled to come back into effect early next year. Others in HCMC's private sector argue that there is now a capital shortage in Vietnam that additional stimulus will help relieve. Most agreed that because the proposed second package is considerably smaller than the first, it will primarily have a psychological effect.

¶10. (SBU) Comment. The political interest in strong GDP growth at this point appears to have overcome the economic argument for ending economic stimulus. Concern over the financial health of some of Vietnam's largest SOEs, who could be helped by continued subsidized interest rates, could have also played a role in the decision making process. At the same time, the reduction of the interest rate and the phasing out of tax breaks likely indicates that decision-makers are not ignoring inflation concerns and think they can control inflation in 2010. End comment.
Michalak